

April 1, 2019

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Commissioner Carla Peterman, Chair  
Commissioner Dave Jones  
Commissioner Michael Wara

Commissioner Michael Kahn  
Commissioner Pedro Nava  
Executive Officer Evan Johnson

**RE: April 3 Meeting of the Commission on Catastrophic Wildfire Cost and Recovery**

Dear Commissioners:

Southern California Edison (SCE) appreciates the Commission's important work to help California improve its approach to wildfire prevention and response that ensures a resilient energy infrastructure that supports achievement of the State's clean energy goals. As this Commission examines climate change, catastrophic wildfire costs and their implications for utilities, there is a need to restore the regulatory framework that flows from our obligation to provide electricity to all customers, regardless of risk. We understand there is increased interest in risk financing mechanisms, such as securitization and the establishment of a fund. We welcome those discussions and view them as potentially helpful ways to manage the increasing risk and scale of wildfire damages. However, solutions that do not restore certainty and predictability to the cost recovery process at the California Public Utilities Commission (CPUC) would be incomplete – whether the issue is recovery of costs incurred by utilities in directly paying wildfire claims or providing capital to a fund that pays wildfire claims.

We believe that the questions of cost socialization put before this Commission by the legislature necessitate a hard look at the cost recovery process at the CPUC. In return for a duty to serve all customers, regardless of risk, investor-owned utilities (IOUs) are entitled to recover their costs of service in rates, where those costs are determined to be just and reasonable. This is the regulatory framework in its most fundamental form. Today it is broken. Without a predictable, objective process for timely cost recovery at the CPUC, the existing strict liability framework applied to wildfire damages when ignition is substantially caused by utility infrastructure has damaged the utilities' financial health, which will result in higher customer rates. We believe this Commission has the opportunity to recommend needed changes to today's regulatory paradigm.

**Enhanced prevention and strong accountability should be the basis for cost recovery.**

IOUs throughout the State are enhancing their electrical systems to mitigate wildfire risk and investing in clean energy in order to meet California's core objective of safely delivering reliable, affordable and clean electricity to customers. Key to achieving these and other objectives is continued access to low-cost capital from equity and debt investors, helping keep rates affordable while investing, in the case of

SCE, \$4 to \$5 billion per year, in electric utility infrastructure. The State's increasingly negative investment risk profile has worsened due to recent catastrophic wildfires, the application of inverse condemnation with a strict liability standard, and an unclear and prolonged cost recovery process at the CPUC. This increasingly dire risk profile has already increased customers' costs, mainly the interest obligations arising from recent debt issuances to be recovered in future rates. Last month, SCE issued \$1.1 billion of debt at ~0.85% higher interest rates than non-California peer utilities, which translates to nearly \$200 million of additional interest over the life of the bonds to be paid for by customers. If the risk profile is left unaddressed, it will further increase customer rates due not only to the increased cost of debt on all new issuances, but the elevated cost of equity necessary to maintain debt and equity capital. Equity costs will increase as investors require much higher returns before investing in California utilities, to account for their much riskier profile relative to non-California peer utilities.

In order to restore the market's confidence in California's regulatory framework with IOUs, the State needs durable and objective standards that define utility prudence and a timely process for completing prudence review. We believe this can best be accomplished by mandating that if an IOU has complied with its approved wildfire mitigation plan (WMP), the CPUC should deem the company a prudent operator for cost recovery purposes. The WMPs are comprehensive and cover all aspects of an IOU's wildfire mitigation operations throughout its high fire risk areas which, in SCE's case, are expansive. Consequently, if an IOU's overall performance meets the expectations set forth in its plan, then it is appropriate to conclude that the IOU acted prudently and should be able to recover its associated wildfire-related costs. Compliance with an IOU's WMP is an appropriate standard by which to judge a utility's wildfire mitigation operations since prudence cannot equate to perfect operations, regardless of the industry in question.

That said, the CPUC can and should deny cost recovery for utility wildfire damages in excess of commercial insurance and contributions to a wildfire fund to the extent that a utility's non-compliance with its approved WMP is found to be a significant cause of a wildfire and its damages. In making such a determination, the CPUC should consider all causes of a wildfire ignition and its progression; external factors beyond the utility's control, such as wind, fuel stock, temperature, and low humidity; the extent of development in high wildfire risk areas; and/or to what extent any actors outside the utility contributed to damages. These factors should then be used to create a cost recovery methodology that accounts for external factors beyond the utility's control and limits disallowance risk accordingly. Such denial must be in proportion to other factors that contributed to the wildfire and its damages.

This is not a guarantee of cost recovery or a blank check. Utility shareholders should bear a proportionate share of the costs for utility wildfire damages in excess of commercial insurance and contributions to a wildfire fund, if the CPUC subsequently determines a wildfire and its damages were due to utility conduct that is fundamentally noncompliant with its approved WMP. For example, if an IOU engages in willful misconduct, acts with reckless disregard of consequences, or engages in a persistent pattern of misconduct, such misconduct should be a factor in determining the degree to which utility shareholders should be held liable.

Without an established and durable cost recovery framework for wildfire risk, and given the length of time between a wildfire event and the resolution of cost recovery under the existing process, equity investors will require a higher risk-adjusted return regardless of the ultimate recovery decision. Early

authorization to finance such liabilities would give the markets the certainty they need to enable financing of the liability at a lower cost to customers without stressing credit metrics.

Importantly, if the IOU is later found to have acted imprudently, the CPUC has the authority to issue a disallowance in proportion to the IOU's imprudent conduct that led to the damages caused by the fire without affecting the repayment of any debt that had been issued.

In advance of and independent from a prudency determination, or if a catastrophic wildfire recovery insurance fund is established and does not respond (e.g., loss exceeds fund limits or fund is exhausted), the CPUC should promptly authorize an electric utility to sell bonds to pay property damage claims from catastrophic wildfires that exceed the utility's insurance limits. This debt would be secured by a dedicated rate component. If the utility is deemed imprudent, then shareholders would credit ratepayers for a proportionate share of the debt service.

Establishing this clear process will have the benefit of stabilizing the energy landscape while this Commission and the Legislature consider potential additional and complementary longer-term solutions for the current crisis.

**A catastrophic wildfire recovery insurance fund (Wildfire Fund) should be established to achieve broad risk and cost sharing that covers property damage resulting from wildfires caused by electric utility ignitions.**

In the case of a wildfire covered by the Wildfire Fund, IOU shareholders would be responsible to pay a portion of the post-loss increased premium to the Wildfire Fund that corresponds with the extent an IOU acted imprudently, if such imprudence was a direct cause of the fire. The Wildfire Fund should be guided by the following principles:

1. **Applicability:** These principles apply to a wildfire fund for wildfires caused by electric utility ignitions.
2. **Governance:** A governing board should be appointed and include representation from the participating utilities (IOUs and POUs); this governing body would make decisions on utility contributions, reinsurance, and other means to reduce ratepayer impacts.
3. **Insurance requirement:** Electric utilities (IOUs and POUs) should be required to continue purchasing commercial insurance; the governing body will require the electric utilities to continue to procure economically feasible amounts of commercial insurance and continue to mitigate wildfire risks.
4. **Fund pays out after utility insurance:** The Wildfire Fund should respond and pay claims for property damage once an individual electric utility's insurance is exhausted.
5. **Required risk mitigation:** Electric utilities should continue to aggressively implement wildfire risk mitigation measures.
6. **Avoid moral hazard:** (1) The CPUC should retain authority to fine/penalize IOUs for conduct or regulatory violations related to a fire; (2) for wildfire covered by the Wildfire Fund, IOU shareholders would be responsible to pay a portion of the post-loss increased premium to the Wildfire Fund that corresponds with the extent an IOU acted imprudently; and (3) willful misconduct and punitive damages are not covered by the Wildfire Fund.

7. Need for pre-loss upfront and annual contributions: The Wildfire Fund should be funded by electric utilities' initial and ongoing, annual premium contributions:
  - a. Premiums should be based on: (1) risk (e.g., miles of distribution line or number of metered customers in high fire risk areas) and (2) modeling/actuarial analysis that includes a factor for implemented risk mitigation.
8. Premiums covered in rates: Initial and ongoing, annual premium contributions to the Wildfire Fund should be covered in rates (like insurance premiums).
9. Securitization: Electric utilities should be able to securitize, with a dedicated rate component, the initial and ongoing, annual premium contributions, and post-loss, as appropriate.
10. Increased premiums for loss-causer after an event funded by shareholders in proportion to the extent an IOU is found imprudent in the cause of a fire: If an electric utility suffers a loss paid by the Wildfire Fund, the Wildfire Fund will require the loss-causer to pay an increased additional premium per underwriting guidelines; recoverability of an IOU's increased additional contributions would be subject to a CPUC reasonableness review, and a portion may be allocated to shareholders proportional to the IOU's misconduct, to the extent such misconduct was a proximate cause of the wildfire.
11. Tax-exempt contributions: The Wildfire Fund should include a tax-exempt feature (both state and federal).
12. Accessing reinsurance and other risk financing: The Wildfire Fund may purchase reinsurance and other risk financing instruments.
13. State contribution: Due to statewide impact of catastrophic wildfire, the State should make regular contributions to the Wildfire Fund; to provide immediate confidence for the capital markets, the State should act as a backstop until the Wildfire Fund is adequately established.

**We Support Clear and Comprehensive Policy Solutions to Mitigate Wildfire Risks**

SCE looks forward to supporting your efforts and deliberations as they progress. We are committed to finding meaningful solutions to these urgent problems and ensuring that our electric system, our customers and our communities, can rise to the challenge of a changing climate that exacerbates our catastrophic wildfires.

Sincerely,



Caroline Choi  
Senior Vice President  
Corporate Affairs